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780-223—65

In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 216

FRED T. MACKEY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. A1–A16) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on April 1, 1965 (Pet. A16–A17) and a petition for rehearing was denied on May 13, 1965 (Pet. A17–18). The petition for a writ of certiorari was filed on June 4, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, in a prosecution for income tax evasion proved by the net worth method, there was suffi-

cient evidence to establish with reasonable certainty petitioner's net worth at the beginning of the prosecution years.

2. Whether the prosecution had a duty, during the closing two weeks of a seven-weeks trial, to analyze and summarize a mass of basic insurance company records (policy applications) in order to foreclose the possibility that some of the unreported income charged to petitioner may in fact have arisen from unrecorded and unreported income of the insurance companies, where the defense produced the applications belatedly and in a state of disarray and where the books of the insurance companies—upon which the government relied—were in agreement with their federal income tax returns and their annual reports to the Indiana State Department of Insurance.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX.
>
> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. (1958 ed.) 7201.)

STATEMENT

Petitioner was indicted in March 1963 on five counts charging tax evasion for the years 1956 through 1960 by causing false and fraudulent tax returns to be prepared, in violation of Section 7201 of the Internal Revenue Code of 1954. The total tax deficiencies alleged for the five-year period were $999,341.72. (A.A. 13–20.)[1] After a jury trial lasting seven weeks, appellant was convicted on all counts, fined $10,000 and costs, and sentenced to five years in prison. (A.A. 69–70.)

The government's case was proved by the net worth method. The evidence showed that the visible net worth of petitioner and his wife at the starting point, December 31, 1955—including assets held in the names of the Gibraltar insurance companies and other nominees for the benefit of petitioner—amounted to $361,461.52, a figure substantially greater than all of the income reported by appellant and his wife since 1929; that, by the end of the prosecution years, this visible net worth had increased to more than one and a half million dollars, although during that five-year period petitioner and his wife had reported only $143,339.24 of taxable income; and that petitioner had a likely source of taxable income in the policy wheel (numbers banker) operation which he admittedly carried on throughout the years in

[1] The designations "A.A." and "G.A." refer to the Appellant's Appendix and the Government's Appendix in the court below. The March 1963 indictment was superseded as to its last four counts by an indictment filed on October 2, 1963, making only minor changes in the original allegations. (A.A. 17–20.)

question. (Govt. Exs. 9 through 13—Schedule C, 96, 97, 730, 759, 760, 765, 800; A.A. 1340, 1344–1348, 2102 *et seq.*; G.A. 27–28.)

The amounts of taxable income and income tax liabilities reported on petitioner's returns compared with the correct amounts, as proved at the trial, are as follows (Govt. Exs. 9 through 13, 800 through 802; A.A. 2103–2153):

Taxable income

Year	Correct amount	Reported amount	Unreported income
1956	$209,108.95	$17,315.54	$191,793.41
1957	350,681.63	13,452.72	337,228.91
1958	378,408.95	33,884.68	344,524.27
1959	138,157.27	39,593.38	98,563.89
1960	72,078.06	39,092.92	32,985.14
Total	1,148,434.86	143,339.24	1,005,095.62

Income tax

Year	Correct amount	Reported amount	Unreported tax
1956	$134,508.61	$3,209.08	$131,299.53
1957	255,277.42	2,015.45	253,261.97
1958	279,213.45	9,353.31	269,860.14
1959	77,456.38	12,097.89	65,358.49
1960	31,503.62	11,946.68	19,556.94
Total	777,959.48	38,622.41	739,337.07

In addition to his policy wheel business, petitioner operated the Gibraltar Industrial Life Insurance Co. and the Gibraltar Mutual Life Insurance Co. and, beginning in 1957, the M.W.E. & S. Investment Co., Inc. The principal issue at trial was whether the government was justified in including in petitioner's

net worth certain assets acquired in the names of the Gibraltar companies.[2] (Cf. Pet. 15.)

Gilbraltar Industrial, which was chartered by the State of Indiana, maintained offices in Indianapolis and Gary. (Govt. Exs. 125–129; A.A. 1128–1129, 1564–1565.) Although the corporation had no stockholders, petitioner acquired an interest in it in 1947 and was chairman of the board during the years named in the indictment. (Govt. Ex. 113; A.A. 499, 1293, 1572–1573; G.A. 34.) All of the officers of the company were related to petitioner by blood. (Govt. Exs. 125–129; A.A. 497, 546, 576, 583, 743, 753, 1291–1293). The company's office was run by Mrs. Fannye Benford, petitioner's sister (A.A. 497). As treasurer, she was responsible for all of the company's financial transactions (A.A. 499, 772–773, 869, 916, 1293). At the trial, Mrs. Benford first testified that the books and records were complete with respect to the company's income and financial transactions (A.A. 775–777, 978–979), but later testified that the company received substantial premium income which was not recorded (A.A. 1227–1229). These books, however, were the basis for the annual reports submitted by the company to the Indiana State Department of

[2] Because petitioner and the members of his immediate family owned the M.W.E. & S. Investment Co., Inc., and because the income reported by that enterprise may account for some of the net worth increases, the above tabulations of unreported income and tax take into account (*i.e.*, give petitioner credit for) the income reported by M.W.E. & S.—totalling $39,971.35—from the time of its incorporation in 1957 (Govt. Exs. 14–16, 802; A.A. 2153).

Insurance and for the federal income tax returns. (A.A. 305–307, 777–779, 792–793, 1250–1251.) The annual reports to the State of Indiana disclosed that during the five prosecution years the company operated at a loss, realizing gross income of $283,620.58 and disbursing $310,927.17. (Govt. Exs. 125–129.) The company's federal income tax returns for 1958 and 1959 (those for other years having been excluded from evidence) were in substantial agreement with these annnual reports. (Govt. Exs. 22, 23; A.A. 305–307.) The accountant who prepared the reports and returns was never informed that Gibraltar Industrial was acquiring real estate and securities, or that it was making loans, or that there was a bank account in its name into which large deposits were made, or that it had any assets outside of the United States. (Govt. Exs. 481–483; A.A. 841–845, 1286–1287.)

Gibraltar Mutual, like Gibraltar Industrial, was chartered by the State of Indiana, maintained offices in Indianapolis and Gary, and had no stockholders. (A.A. 297, 1567, 1578.) Petitioner began with a $35,000 investment in the company in 1954, added $5,000 in 1959 and another $13,000 in 1960. (G.A. 1.) The officers of the company during the prosecution years included no one except the same five relatives of petitioner (who was chairman of the board) listed as officers of Gibraltar Industrial (Govt. Exs. 140–144; G.A. 35–40). Mrs. Benford, the treasurer, testified that so far as she knew all receipts were recorded on the company's books. (A.A. 772–773, 821–826, 979–

980). The annual reports submitted to the State of Indiana disclosed that during the five prosecution years Gibraltar Mutual received gross income totalling $153,235.22 and made disbursements (including additions to reserves) totalling $154,109.91 (Govt. Exs. 140–144). The federal income tax returns, like those of Gibraltar Industrial, were prepared from the annual reports filed with the State of Indiana. (A.A. 821–826, 1284–1285.)

The Gibraltar companies were located in the same office as the M.W.E. & S. Investment Co., Inc., and the same employees who collected money for the insurance companies collected it for M.W.E. & S. (A.A. 368, 615–616, 862–863, 1057.) Incoming receipts were handled either by Mrs. Benford or by petitioner's secretary, who would record on the companies' books money received from policyholders who came into the office to pay their premiums. (A.A. 615–616, 675, 979.) There was evidence that transactions and funds of the insurance companies were sometimes commingled with those of petitioner and his M.W.E. & S. corporation. (Govt. Ex. 135, p. 6; A.A. 346, 452–453, 795–796; G.A. 27.) The Gibraltar Building itself, though its title was held in the name of Gibraltar Industrial, was reported each year as an asset of M.W.E. & S. on its federal income tax returns. (Govt. Exs. 14–16.)

Although the deductible expenses of the Gibraltar companies were, with rare exception, paid by regular bank check, the investments in securities, loans and real estate unrecorded on the books and unreported

on the tax returns and State Insurance Department reports were paid for in currency or by cashier's check. (A.A. 1268–1271.) Large sums were used to buy cashier's checks for the acquisition of real estate (A.A. 354, 1271–1272) and securities (A.A. 482, 550–551, 572), but the more common practice was to use currency, often in bills of $10 and $20 denominations (A.A. 414, 421). Securities, real estate and other assets acquired in the name of the Gibraltar companies—usually Gibraltar Industrial—were customarily purchased by petitioner with currency from one of the office safes. (A.A. 898–899, 919–920, 925, 933, 935, 937, 941–942, 947, 949–950, 952, 954–955, 964–966, 969, 972–973, 1018–1020, 1032–1033, 1037–1039, 1044–1045, 1067–1068, 1133–1134, 1136, 1197.) The largest single transactions related to petitioner's acquisition of stock in a fire insurance company. An official of that company received $50,000 in currency from petitioner with instructions to issue the stock in the name of Gibraltar Mutual. (A.A. 355–356.) Later, in 1958, petitioner gave the same official an additional $98,000 in currency for the purchase of more shares in the name of M.W.E. & S. (A.A. 360–361.) In 1960 petitioner bought an additional block of stock from another individual, paying him $15,000 in currency. (A.A. 654.)

In addition to the assets acquired in the names of the Gibraltar companies and M.W.E. & S., petitioner sometimes acquired property in the names of relatives, business associates, and once in the fictitious name of "Theodore Pillow". (A.A. 252–253, 268–270,

314, 378–379, 502, 544–548, 558, 572–577, 583, 590, 598, 745–747.) The evidence also established the creation by petitioner of a fictitious $200,000 mortgage liability on the Gibraltar Building. During the investigation petitioner told the Treasury agents that the building was encumbered by a mortgage in that amount, and such a mortgage was in fact listed on the federal income tax returns of M.W.E. & S., which were prepared by an attorney on the basis of information furnished him by petitioner. (Govt. Exs. 14–16; A.A. 883–886, 1341.) Mrs. Benford was unaware of any mortgage (A.A. 794) and the representative of the "mortgagee" testified that no consideration had changed hands, that there was no mortgage, and that his company had allowed petitioner to use its name as a favor to petitioner (A.A. 358–359).

ARGUMENT

1. There is no substance to the argument (Pet. 10–15) that petitioner was improperly convicted because the government's net worth summary gave him no credit for undeposited cash on hand at the starting point. The solidity of the starting point was established by (a) the exhaustive investigation by the Treasury agents, which disclosed no other assets; (b) the study of petitioner's lifetime income tax history, which showed that his total reported income—less income taxes paid—was less than his visible net worth at the starting point; (c) petitioner's failure to claim, either during the investigation or at the trial, any undeposited cash on hand at the starting point; and (d) evidence tending to discredit all of petitioner's

arguments with respect to *possible* undisclosed assets on hand at that time. (Pet. A9–A12; *supra*, p. 3; A.A. 1340, 2103 *et seq.*) This, together with the abundant proof that petitioner is a man who believes in putting his money to work for him, fully supports the jury's inference that at the end of 1955 petitioner did not have enough undeposited cash to impair the government's reconstruction of his unreported income. Cf. *Holland* v. *United States*, 348 U.S. 121, 138–139. Whether he had cash on hand at the various pertinent times is, of course, a matter peculiarly within the knowledge of petitioner, who refused to make any statement on the subject. (A.A. 1340.) In these circumstances the government was not required to credit him with cash on hand, having made a clear-cut *prima facie* case to support the starting point net worth. *Beard* v. *United States*, 222 F. 2d 84, 89 (C.A. 4th), certiorari denied, 350 U.S. 846; *United States* v. *Holovachka*, 314 F. 2d 345, 356–357 (C.A. 7th), certiorari denied, 374 U.S. 809.

The civil cases cited by petitioner (Pet. 13–14) are inapposite not only because they are distinguishable on their facts,[3] but because (1) in civil suits

[3] In *Grubb* v. *Commissioner*, 315 F. 2d 753 (C.A. 6th), the court held that the burden of proof as to cash on hand was on the Commissioner, and that the Tax Court's estimates of cash on hand were arbitrary and "based on a guess". (*Id.*, pp. 758–759.) Since the Commissioner's determination was found, even by the Tax Court, to be wrong, and since the Tax Court's determination was also wrong, the case was remanded for further inquiry into the amount of cash on hand. In the other civil cases relied upon by petitioner (Pet. 13–14) there was

both sides lay their cards on the table, either before trial or at trial, and the cash on hand is thus at least theoretically ascertainable; and (2) in civil cases it is necessary to determine, as accurately as possible, the exact amounts of the tax deficiencies. In criminal cases such precision is unattainable and unnecessary. *United States* v. *Johnson,* 319 U.S. 503, 517–518; *Holland* v. *United States,* 348 U.S. 121, 138.

2. Also unsound is the contention (Pet. 15–17) that the government failed to "track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence." *Holland* v. *United States, supra,* pp. 135–136. The short of it is that petitioner refused to furnish leads. (A.A. 1340–1341.) The argument that the government, in the closing two weeks of the trial, should have analyzed and summarized the policy applications of the Gibraltar companies, weighing some 830 lbs., is frivolous. The government relied upon the companies' books, tax returns, and reports to the State of Indiana, as it was entitled to do, in ascertaining their assets, income and disbursements. *United States* v. *Hornstein,* 176 F. 2d 217, 220 (C.A. 7th); *United States* v. *Link,* 202 F. 2d

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substantial evidence of cash on hand which was ignored by the Commissioner and the trial courts.

In *United States* v. *Costello,* 221 F. 2d 668, 673 (C.A. 2d), affirmed on other grounds, 350 U.S. 359, a criminal case, there was before the court a great deal of evidence of the defendant's financial history for years prior to the prosecution period, which disclosed that "* * * in the past he had always kept such [cash] reserves in large amonuts."

592, 593–594 (C.A. 3d); *United States* v. *Bender*, 218 F. 2d 869, 871–872 (C.A. 7th), certiorari denied, 349 U.S. 920; cf. *Warszower* v. *United States*, 312 U.S. 342, 347. The petitioner's belated production of the policy applications[4] came much too late, for even if these records showed which policies had lapsed and when, and the amounts of the weekly premiums (and there is no indication that they did), it obviously would have been a physical impossibility to summarize them and compare them with the companies' books in the remaining days of trial.[5] The admonition in the *Holland* case as to the government's duty to track down leads refers to leads furnished to the Treasury agents during their investigation, not to possibilities suggested to the prosecutor near the close of the trial.

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[4] If these policy applications were relevant at all, they became so only when Mrs. Benford changed her testimony late in the trial, retracting her testimony that the Gibraltar companies' books were true and complete and now stating that substantial premium receipts were unrecorded. At that point, it became apparent that the companies were in possession of these policy applications and had failed to produce them in compliance with the trial subpoena, which called for the production of all books and records of the companies. The court then ordered their production. (A.A. 1264–1265.)

[5] The applications were in such a state of disarray that one witness estimated it would "take two or three months to put them back together." (A.A. 1314.)

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY, 1965.

U. S. GOVERNMENT PRINTING OFFICE : 1965